

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

APPLICATION OF KENTUCKY-AMERICAN)
WATER COMPANY FOR CERTIFICATION) CASE NO. 9093
OF DEPRECIATION)

O R D E R

On June 29, 1984, Kentucky-American Water Company ("Kentucky-American") filed its application with the Commission wherein it proposed to revise its depreciation rates and methods to be effective on January 1, 1985. Kentucky-American requested certification of a depreciation schedule determined by the remaining life technique which included the reduction of the service lives of a majority of the plant accounts and the assignment of negative salvage values to several of the plant accounts. Kentucky-American requested an increase in the composite accrual rate from 1.46 percent to 2.31 percent annually -- an increase of \$488,412.

In this Order the Commission has allowed the use of the remaining life technique and the modification of the service lives of a number of the plant accounts. The changes allowed by the Commission result in a composite accrual rate of 1.82 percent annually for an increase of \$211,160 in the annual depreciation expense.

A hearing was held on January 23, 1985, in the Commission's offices in Frankfort, Kentucky, following notice given pursuant to the Commission's regulations. The Consumer Protection Division of the Attorney General's Office intervened in this matter, but did not participate in the hearing.

BACKGROUND

In its previous request for a rate adjustment (Case No. 8836) Kentucky-American proposed a significant change in the method of calculating its depreciation expense. The adjustment requested in that case would have increased the composite accrual rate from 1.44 percent to 2.16 percent annually. The major components of the change in depreciation computations proposed in Case No. 8836 dealt with the reduction of the service lives of a majority of the accounts, the use of the remaining life technique, and the assignment of negative salvage values to several accounts. The Order in Case No. 8836 entered December 20, 1983, disallowed the changes in computing depreciation expense proposed by Kentucky-American. The Order further stated that a change in Kentucky-American's depreciation structure in the magnitude proposed would require considerable detailed consultation with the Commission's technical staff and a hearing devoted to that single issue. After an initial consultation with the Commission's staff, Kentucky-American was instructed to file an application in general conformity with the requirements of 807 KAR 5:064.

On August 16, 1984, the Commission entered an Order of Procedure in this case stating that the guidelines set out for investigating depreciation rates for telephone companies in 807 KAR 5:064 would be followed as closely as possible. A Motion for Full Intervention by the Attorney General's Consumer Protection division was granted by the Commission on August 31, 1984.

On September 28, 1984, the Commission staff submitted a report for the record containing the staff proposal for modifying the depreciation expense of Kentucky-American. The September staff proposal accepted the use of the remaining life technique, rejected the majority of the shortened service lives, and rejected Kentucky-American's assignment of negative net salvage values for its plant accounts. The September staff report proposed a composite accrual rate of 1.56 percent annually for an increase of \$58,539.

In conformance with the August 16 Order of Procedure, an informal conference was held on this matter October 25, 1984, at the Commission's offices in Frankfort. The purpose of the conference was the review of proposed rates and methods and the development of an agreed depreciation schedule by the Commission staff and Kentucky-American. James D. Brannen of the Attorney General's Consumer Protection Division also attended the conference. At that meeting Kentucky-American and the staff discussed three components of the proposed depreciation expense: Reserve Balance, Net Salvage and Remaining Life. Kentucky-American's allocation

of the depreciation reserve balance was based on a theoretical reserve study conducted by the "prospective" method, while the staff's allocation had been determined by a "retrospective" analysis. Kentucky-American expressed its preference for the prospective method but accepted, subject to review, the staff's allocation. The staff was unable to concur with the negative salvage estimates proposed by Kentucky-American, and no agreement was reached on the Net Salvage component. The Commission staff and Kentucky-American did reach a compromise, however, on the Remaining Life component.

On December 5, 1984, the staff submitted to the Commission a revised proposal for modifying the depreciation expense of Kentucky-American. The depreciation expense proposed by the Commission staff was revised to reflect the adjustments in service lives reached at the October 25, 1984, conference. The revised staff proposal increased the composite depreciation rate for Kentucky-American to 1.82 percent annually. This increase, resulting in an additional \$211,160 annually, was primarily due to the staff's adjustments to shorten the service lives for Accounts 332.9--Water Treatment Equipment, 343.0--Transmission and Distribution Mains, and for the subaccounts under 346--Meters.

At the hearing in this matter held January 23, 1985, Kentucky-American stated for the record that it accepted the Commission staff's revised proposal dated December 5, 1984, in all its particulars as its compromise application.

Kentucky-American requested that it be allowed to delay booking any increased depreciation expense until it had been granted a corresponding increase in revenues by the Commission.

COMMENTARY ON REQUEST
FOR DELAY IN EFFECTIVE DATE

The Order of Procedure entered August 16, 1984, stated that the guidelines set out for telephone companies in 807 KAR 5:064 would be followed as closely as possible. 807 KAR 5:064 states, in effect, that the effective date for booking depreciation changes is intended to be January 1 following the filing date. This procedure is consistent with the current practice of the Federal Communications Commission ("FCC") and other state regulatory agencies. The issue of effective dates has been considered repeatedly in recent depreciation orders of the FCC. The FCC generally allows effective dates for new depreciation rates any time between January 1 of the filing year and January 1 of the following year. While the preferred effective date of new rates would coincide with the study date, the practical problems associated with the determination, review, and approval of any change in depreciation rates necessitates a less restrictive time frame. However, lacking substantial evidence to the contrary, the Commission does not feel that the effective date required by 807 KAR 5:064 is improper in this case.

FINDINGS AND ORDERS

The Commission, after consideration of the evidence of record and being advised, is of the opinion and finds that:

1. The percentages of depreciation set forth in Appendix A of this Order are the fair, just and reasonable expense rates for Kentucky-American's plant accounts.

2. The reserve balances set forth in Appendix A of this Order are the fair, just and reasonable allocation of Kentucky-American's total reserve balance for its plant accounts ending December 31, 1983.

3. The depreciation rates allowed in this matter on a test period basis should permit Kentucky-American to adequately book recovery of its capital investment over the remaining lives of its plant accounts.

4. The delay in the effective date of the depreciation percentages requested by Kentucky-American was not shown to be reasonable and should be denied.

IT IS THEREFORE ORDERED that the percentages of depreciation set forth in Appendix A of this Order be and they hereby are prescribed effective on January 1, 1985.

IT IS FURTHER ORDERED that Kentucky-American shall adjust the assignment of its reserve balance to conform to the allocation of the December 31, 1983, reserve set forth in Appendix A of this Order.

Done at Frankfort, Kentucky, this 12th day of March, 1985.

PUBLIC SERVICE COMMISSION


Chairman


Vice Chairman


Commissioner

ATTEST:

Secretary

APPENDIX A

APPENDIX TO AN ORDER OF THE PUBLIC SERVICE COMMISSION IN CASE NO. 9093 DATED 3/12/85

The following depreciation percentages are prescribed effective January 1, 1985, for the plant accounts of the Kentucky-American Water Company.

Acct. No.	Description	12/31/83 Reserve Balance	Reserve Ratio	Future Net Salvage	Average Remain. Life	Annual Rate
		Dollars	Percent	Percent	Years	Percent
311.0	Source of Supply Struct & Imp	5355.	31.24	0.0	58.8	1.17
312.0	Collecting & Imp Reservoirs	49061.	23.72	0.0	115.7	0.66
313.0	Lakes, Rivers & Other Intakes	73911.	23.37	0.0	60.2	1.27
316.0	Supply Mains	162678.	13.59	0.0	76.3	1.13
321.0	Pumping Struct & Improvements	167828.	19.19	0.0	48.1	1.68
323.2	Other Power Prod Equipment	13688.	15.54	0.0	28.8	2.93
325.0	Electric Pumping Equipment	827118.	29.86	0.0	23.0	3.05
326.0	Diesel Pumping Equipment	65395.	28.65	0.0	26.6	2.68
328.2	Gasoline Power Pumping Equip	453.	84.83	0.0	12.9	1.12
331.0	Water Treatment Structures	172219.	18.40	0.0	48.8	1.67
332.0	Water Treatment Equipment	840282.	10.63	0.0	44.5	2.01
342.0	Dist Reservoirs & Standpipes	320783.	28.89	0.0	31.8	2.24
343.0	T & D Mains	3660161.	12.94	0.0	76.4	1.14
345.0	Services	989649.	22.07	0.0	40.7	1.91
346.1	Meters - Mechanical	137247.	39.39	20.0	4.5	9.02
346.2	Meters - Plastic	23702.	4.33	0.0	7.1	13.47
346.3	Meters - Other	121547.	23.95	20.0	23.9	2.35

<u>Acct.</u> <u>No.</u>	<u>Description</u>	<u>12/31/83</u> <u>Reserve</u> <u>Balance</u>	<u>Reserve</u> <u>Ratio</u>	<u>Future</u> <u>Net</u> <u>Salvage</u>	<u>Average</u> <u>Remain.</u> <u>Life</u>	<u>Annual</u> <u>Rate</u>
		<u>Dollars</u>	<u>Percent</u>	<u>Percent</u>	<u>Years</u>	<u>Percent</u>
347.0	Meter Installations	562879.	19.52	0.0	41.8	1.93
348.0	Hydrants	244574.	10.02	10.0	64.5	1.24
390.1	Office Structures	145250.	13.89	0.0	40.1	2.15
390.2	Stores, Shop & Garage Structures	7506.	32.40	0.0	30.3	2.23
390.3	Misc. Structures	12828.	39.73	0.0	33.2	1.81
391.1	Office Furniture	34230.	41.17	0.0	14.9	3.95
391.21	Data Handling Equip	15171.	29.71	0.0	8.5	8.27
391.22	Other Office Equip	361.	3.82	0.0	4.3	22.37
392.11	Trans Equip - Light Trucks	83004.	32.89	25.0	3.9	10.80
392.12	Trans Equip - Heavy Trucks	45543.	84.88	20.0	6.3	-0.78
392.2	Trans Equip - Cars	31677.	21.22	20.0	4.1	14.34
392.3	Trans Equip - Other	494.	84.88	0.0	5.5	2.75
393.0	Stores Equip	7214.	79.78	0.0	7.9	2.55
394.0	Tools, Shop & Garage Equip	37323.	30.98	0.0	12.8	5.39
395.0	Laboratory Equip	25386.	23.34	0.0	14.9	5.14
396.0	Power Oper Equip	19016.	20.37	50.0	5.7	5.20
397.0	Communication Equip	19394.	19.95	0.0	10.7	7.48
398.0	Misc Equipment	10988.	22.49	0.0	15.8	4.90